MINUTES

BOARD OF TRUSTEES OF THE PUBLIC EMPLOYEES' RETIREMENT FUND 143 West Market Street, Suite 500 Indianapolis, IN 46204

December 14, 2001

<u>Trustees Present</u>

Jonathan Birge, Chair
Richard Doermer, Vice Chair
Nancy Turner
Teresa Ghilarducci
Steven Miller

<u>Others Present</u>

Mike Gery, Executive Assistant to the Governor
Diana Hamilton, Indiana Development Finance Authority
Stephanie Grieser, William M. Mercer Investment Consulting
Micah Fannin, William M. Mercer Investment Consulting
Dick Boggs, Burnley Associates
Mary Beth Braitman, Ice Miller
Eric Swank, Ice Miller
Doug Todd, McCready & Keene, Inc.
Karen Franklin, National City Bank
E. William Butler, PERF Executive Director
Patricia Gerrick, PERF Chief Investment Officer
Joseph Duncan, PERF Investment Analyst
Diann Clift, PERF MIS Director
Ed Gohmann, PERF Legal Counsel
Patrick Lane, PERF Director of Communications
Tim Legesse, PERF Investment Analyst
Doug Mills, PERF Chief Financial Officer
Jim Osborn, PERF Project Director
Tom Parker, 1977 Police and Firemen Fund Director
Kevin Scott, PERF Director of Benefits Administration
Kenneth Stoughton, PERF Director of Human Resources
Tommie Wilson, PERF Investment Assistant
Lynda Duncan, Minute Writer

ITEMS MAILED TO THE BOARD PRIOR TO MEETING

A. Agenda of December 14, 2001 Meeting
B. Minutes:
- November 9, Board of Trustees Meeting
- November 9, 2001 Benefits Administration Committee Meeting
- Reports, Summaries, Memorandums and/or Letters Concerning:
  - Experience Study for Years 1995 through 2000
  - PERF Resolution No. 01-02
  - Summary of Application of Line of Duty Death Benefit
  - New Units and Enlargements
  - November 28, 2001 Investment Committee Agenda and Supporting Documents

A quorum being present, the meeting was called to order.

1. MINUTES APPROVAL

MOTION duly made and carried to approve the Minutes of the November 9, 2001 meeting of the Board of Trustees.

Proposed by: *Steven Miller*
Seconded by: *Teresa Ghilarducci*
Votes: *5 for, 0 against, 0 abstentions*

2. DISCLOSURES

Richard Doermer – Bank One stock ownership.

3. ADMINISTRATIVE

- The presentation by Mr. Tony Armstrong of the 21st Century Fund was deferred to a later meeting.

- Committee Appointments. It was agreed that the composition of the Board's sub-committees for 2002 would be as follows:

  - Investment Committee: Steven Miller (Chair), Teresa Ghilarducci, Jonathan Birge

  - Combined Budget and Audit Committee: Richard Doermer (Chair), Nancy Turner

- Benefits Committee: Nancy Turner (Chair)
  Jonathan Birge

➢ Board Meeting Dates for 2002.

January 16 (Wednesday)
February 8
March 8
April 12
May 10
June 14
July 12
August – no meeting
September 13
October 11
November 8
December 13

Board of Trustee Meetings will commence at 1.00 p.m. It was further agreed that the Investment Committee would meet at 9.00 a.m. and the Benefits Administration Committee at 11.30 a.m. on the same date as the Board of Trustee meetings.

➢ EXECUTIVE DIRECTOR'S REPORT

a. Telecommunications Project. This issue had been addressed in more detail at the Benefits Administration Committee meeting that morning. The Board members reemphasized the high priority given to this project. PERF's telephone system was unsatisfactory and a solution had to be found. Mr. Butler had continued discussions with Mr. Christopher of the Teachers Retirement Fund (TRF) and other members of the State department. The solution involved several issues such as equipment and training of personnel. Mr. Birge advised that he would present a proposal for a solution to the Board at their January meeting.

b. Actuarial Experience Study. Mr. Doug Todd of McCready and Keene provided:

(1) The results of an actuarial investigation to compare current actuarial assumptions with the actual experience of PERF's pension plan during the years 1995 through 2000; and

(2) his recommendations for changes to the actuarial assumptions where necessary. There was a statutory requirement to review the actuarial assumptions at least once every five years. His results included the following recommendations:

- Cost-of-Living. No change was recommended at this time. The current assumption is a 2% annual cost-of-living adjustment (COLA).

- Salary Scale. This represented the major change to previous assumptions. The current assumption was a flat rate of 5% a year, regardless of age. The proposed new salary scale ranges from as high as a 17% annual increase to a 3.5% annual increase based on age. One single salary scale had been chosen for all four categories of members, viz. state female members, state male members, municipalities female members, and municipalities male members. Salary increases among these four categories were not significant.

- Retirement rates. Retirement rates were recommended to be changed slightly. The experience of the last five years was close to the retirement rate assumption used, which was remarkable, because the "Rule of 85" retirement eligibility was adopted in 1995 and the experience indicated that this had little effect on the rates of retirement. Mary Beth Braitman noted that this factor was significant with regard to current discussion on proposed changes to legislation whereby currently members could go into full retirement pay status while continuing in full-time employment. It was noted that 62 was the earliest age when a person could receive federal Social Security retirement benefits although at a reduced rate. Sixty-five is the age when unreduced Social Security retirement benefits may be received. Males tended to retire earlier than females.

- Turnover Rates. A significant increase in the turnover rates was recommended due to actual plan experience that had revealed that turnover had increased sharply over the past five years. Turnover rates were calculated separately for males and females, for ages 20 though 70, and for the state and municipalities' employees. The sharp increase in turnover rates was attributed to the good economy that had promoted a worker's market. Corporate businesses tended to have a higher turnover rate.

- Mortality Rates. Pre-retirement death rates had been lower than assumed. It was therefore recommended that the pre-retirement mortality rate for females should be reduced by 40% and the rate for males should be reduced by 50%.

- Disability Rates. Experience had shown a decrease over the last five years and therefore it was recommended to reduce the male and female rates by 25% and 10% respectively.
- Post-Disablement Mortality. No change was recommended.

MOTION duly made and carried to adopt the actuarial rates as set forth in the Actuarial report dated December 12, 2001 as the actuarial assumptions effective July 1, 2001.

Proposed by: *Teresa Ghilarducci*
Seconded by: *Jonathan Birge*
Votes: *5 for, 0 against, 0 abstentions*

Teresa Ghilarducci added that she felt comfortable with the assumptions and where judgement had been required, the assumptions were conservative. She considered that the Board should be biased towards the conservative.

4. INFORMATION TECHNOLOGY

a. SIRIS. Testing of SIRIS Stage II would commence soon and the test environment had already been set-up in Building 125. Rollout was scheduled for March 28, 2002.

b. Back-file Project. A list was provided of additional documents, e.g. employer files and legal documents, to be converted into electronic images. This entailed about 2.4 million images, at a cost of $515,000. Staff that had used the imaging had noted that the system was convenient and efficient. The total cost of the original project was $1.4 million. This would be completed at the end of May 2002. All images are stored on a central server and are backed up regularly on site. The permanent images are stored on a “jukebox” that cannot be modified. All document servers are located in the Government Center South. Documents that have been scanned are quality-assured before being transferred to the warehouse for storage.

MOTION was duly made and carried to approve expenditure of $515,000, which represented the additional cost of backfiling documents not included in the original estimate.

Proposed by: *Richard Doermer*
Seconded by: *Teresa Ghilarducci*
Votes: *5 for, 0 against, 0 abstentions*

Mr. Doermer noted that approximately 2 million documents would be rendered permanent by this process and he asked if this was proceeding according to schedule. He was advised that project had been delayed initially by approximately 2 months due to a quality assurance problem; however this had been resolved, scanning had resumed in April that year and the project was on track. Scanning of the additional documents would be completed by the end of May 2002.

5. LEGAL ISSUES.

a. Noble County. At the last Board meeting (November 9, 2001), the concept was approved of waiving a 1% minimum contribution rate, if the employer would meet two tests (laid out in the proposed resolution). The 1% contribution rate can only be waived if: The employer's valuation assets exceed the present value of that employer's future benefits by at least $300,000; and, if the employer's funded status is at least 175%. If the employer meets these tests, the minimum employer contribution rate would be waived. Currently, only three employers with active members would fall into this category.

MOTION duly made and carried to approve the amendment to the "Smoothing Rules" for Employer Contribution Rates as set out on Resolution No. 01-02.

Proposed by: *Richard Doermer*
Seconded by: *Teresa Ghilarducci*
Votes: *5 for, 0 against, 0 abstentions*

b. Building Project. The city was planning to convert the Blocks Building in West Market Street into apartments and condominiums. The Blocks Building is adjacent to PERF's building at 125 West Market Street. An agreement was being negotiated between the developer of the project, PERF and the City of Indianapolis for the alley between the two buildings. The closure date for the project will be December 20

6. BENEFITS

a. The Benefits Advisory Committee had met that morning. Nancy Turner provided highlights of the meeting, as follows:

- Employer Advisory Group (EAG). It was noted that the EAG would be split into two sub-groups (sponsor group and operational group). The EAG met on November 13 at PERF when they were briefed on issues facing PERF and also how this fitted into the SIRIS project. They were provided information on the Pension Management Oversight Commission (PMOC) agenda. The visit included a walk-through tour of PERF's departments.

- Staff Development. Six of the eleven positions approved by the Hiring Freeze Committee had been filled. This left the Internal Auditor position, two positions in the Finance Section, and two in the Benefits section. Recruitment for these positions was in progress. The Internal Auditor position will be republished in the next issue of the IBJ.

- Call Center. An update was provided.

b. Units and Enlargements.

A MOTION was duly made and approved to adopt seven new units and 23 enlargements.

Proposed by: *Nancy Turner*
Seconded by: *Teresa Ghilarducci*
Votes: *5 for, 0 against, 0 abstention*

c. Member Service Reporting. This was provided as an FYI item. At the end of October, there were 497 retirement applications pending processing. At the end of November, this number had been reduced to 368 applications. The optimum situation is to be current on all processing and to process applications within 30 days. It was noted that disability applications were more difficult to process because of the supporting medical data required.

7. 1977 FUND ADVISORY COMMITTEE. Tom Parker provided highlights of the 1977 Fund Advisory Committee meeting held on November 26, 2001.

- Line-of-Duty Death Benefit Award.

  MOTION duly made and carried to approve the Line-of-Duty Death Award in the case of Mr. Jason Baker, Marion Country Deputy, who was shot and killed while attempting to make an arrest on September 11, 2001.

  Proposed by: *Teresa Ghilarducci*
  Seconded by: *Steven Miller*
  Votes: *5 for, 0 against, 0 abstentions*

- Issues presented at the Pensions Management Oversight Committee (PMOC) Meeting. The Committee was provided with a summary of topics addressed during the last PMOC meeting.

- Report on Guns and Hoses Seminar held in Las Vegas. Two of the members of the 1977 Fund Advisory Committee had attended the above conference held in Las Vegas, 30 September to October 2, 2001. Both had found the conference to be professionally rewarding and a good forum for exchange of information and ideas. Amongst other topics, the subject of DROP programs had been addressed.

- Evansville Park Rangers. The Evansville park rangers joined the 1977 Fund in 1998. A decision was now required as to which local pension board would have authority over this group. It was also noted that there were various law enforcement agencies in the State that had expressed an interest in becoming 1977 Fund members. Recommendation was made by the Committee that the PMOC should be asked to carry out a review of all those units of government wishing to enter the Fund (e.g. Transport Authority, Town Marshals, Indianapolis Park Rangers). Teresa Ghilarducci noted that it would be of interest to know how many other agencies around the state might fall under the purview of PERF. Mary Beth Braitman, Ice Miller, advised that some of this data might be available through the Indiana Association of Cities and Towns (IACT) and the Association of Indiana Counties (AIC).

8. INVESTMENTS

a. Report on November 28, 2001 Investments Committee Meeting.

- Strategic Allocation. A summary of the Board approved strategic allocation was reviewed. Staff recommended ranges for each style group within asset classes. Approval of the recommendation would provide a basis for development of a rebalancing plan. The ranges would allow rebalancing within asset classes and style groups. The Fund is currently underweight mid cap equity and overweight fixed income. The Investment Committee presented the recommendation for full Board consideration.

  - Teresa Ghilarducci noted that the Fund was moving away from passive investment. During the discussion that followed, staff noted index and enhanced index strategies continue to dominate the Fund's strategy within large cap equity exposure, where the market is most efficient. The Board questioned justifying the fees for active management. Index and enhanced strategies are targeted at 30% of the total Fund. The implementation plan focuses on concentrated strategies for large cap active exposure and represents only 10% of the total Fund exposure. These are high-expected alpha strategies. This is an area where statistically more managers beat the index over market cycles. Staff was asked to develop a format by which the Board is provided net of fee performance for all portfolios.

  MOTION duly made and carried to adopt the recommended asset allocation and style ranges, as shown, to facilitate establishment of a rebalancing plan.

  Made by: *Steven Miller*
  Seconded by: *Richard Doermer*
  Votes: *5 in favor, 0 against, 0 abstentions.*

  - Teresa Ghilarducci noted that the strategic goals were originally selected following an asset liability study. The Board subsequently adopted additional performance requirements that were reviewed within a shorter timeframe. Staff noted the review of a manager was independent of the asset allocation decision. Managers are reviewed based upon risk adjusted returns compared to benchmarks and peer groups in consideration of the market environment. The strategic goals are based upon underlying liabilities. In discussion it was noted that the real time frame to evaluate a manager's ability is approximately three to five years. Currently the Fund has 21 managers that are evaluated extensively on a semi-annual basis and routinely through quarterly performance reviews and organizational updates.

- International Transition. Morgan Stanley worked with JP Morgan Chase and Williams Capital Group (who executed approximately 15% of the transactions) to transition international equity assets of $424 million for PERF. The transition involved two target managers' portfolios. The markets were very volatile during the transition and on both days of trading the portfolio experienced over 400 basis points of intraday movement. Due to the extreme volatility of the markets, the trading was spread evenly over two days to reduce the risk of a single day's move. Approximately 11% of the portfolio was crossed through Morgan Stanley. The overall cost of the transition was 219 basis points. The execution was less than 25% of the portfolio's bid-ask spread. The bond portfolios served as a source of capital and were liquidated the third week in September. The actual purchase of securities was executed in the last week of September.

- Brandes Funding. The market rallied following the September 11 tragedy. The securities requested for the international funding appreciated and less cash was required to fund GE and Capital Guardian. As a result, Brandes was funded with $15 Million on November 30 from the transition account. The following additional funding was recommended: $50 Million in the 1st Quarter 2002, $50 Million in the 2nd Quarter 2002 and $100 Million in August 2002. Staff suggested it was prudent to spread out the allocation to Brandes until the completion of remaining search required for the global equity allocation. While Brandes has an outstanding performance history, the strategy is deep value and additional diversification will be obtained to offset the volatility of this concentrated portfolio upon completion of the global equity search.

MOTION was duly made and carried to fund Brandes up to the recommended amount by August 2002.

Proposed by: *Steven Miller*
Seconded by: *Richard Doermer*
Votes: *5 in favor, 0 against, 0 abstentions*

- Mr. Doermer asked what percentage would be allocated to Brandes from the Fund's total international equity (approximately 10%). He was advised that Brandes' allocation was about 2% of the total Fund. Half of the global mandate is funded through the international target and half from the domestic equity target. Compared to other Public Funds, PERF has a fairly conservative exposure to international investments.

- Western Asset Management Portfolio. Western currently manages a Core Active Fixed Income Account. The Board subsequently approved expansion of the assignment to a Core Opportunistic mandate. The investment guidelines were not revised to reflect this assignment. Staff requested confirmation and authorization to execute the required documentation. Western's mandate would be expanded to include the following: No more than 20% of the portfolio may be invested in non-US dollar denominated government or non-US dollar denominated corporation securities. No more than 10% of the portfolio may be rated lower than Baa3 (Moody's) or the equivalent Steven Miller noted that Western had developed a web page through which much of their research is distributed and which may be of use to the Trustees.

- 2002 Manager Searches. Actual dates of the Request For Proposal (RFP), Semi-Finalist Determination, Due Diligence Visits, and Approval had not been specified pending confirmation of the 2002 Board meeting dates. Staff and Mercer will recommend potential candidates and establish a list of candidates for Investment Committee review. Staff will conduct on-site due diligence visits. The Investment Committee will interview the finalists and make a recommendation to the Board. Timeframes are as follows:

  - Small/Mid Cap Manager Search: January 2002 – April 2002
  - Concentrated and Index/Enhanced Index Large Cap Manager Search: March 2002 – June 2002
  - Global Manager Search: June 2002 – September 2002

b. Enron. Information on Enron was distributed. As a result of the Enron collapse, the Fund realized losses approximating $22 million based upon exposure as of September 30, 2001. The losses included both bond and equity exposure.

c. Mercer's Client Conference will be held February 3 to 5, 2002. The Agenda will be sent out via e-mail. The Keynote Speaker will be former Mayor Giuliani. Attendees will be from the public and private sectors.

d. Fund Updates. Mr. Doermer asked if it would be possible to receive information on the consolidated Fund portfolio on a monthly basis, which would include year to date figures and actual dollar amounts. Mercer will provide a monthly overview. Diana Hamilton noted that the Standard and Poors rating agency was focusing on projected funding levels for State Pension Funds. Since the markets have experienced significant declines S&P is trying to determine if States must make substantial contributions to shore up their pension funds when assessing credit ratings. During the next fiscal year, PERF should remain fully funded due to the actuarial smoothing method currently in place to reduce the impact of volatile markets on funded status.

9. ACCOUNTING/FINANCIAL. PERF's budget will be redone effective July 1, 2001 in order to reflect more accurately the number of people that had been hired. Richard Doermer and Nancy Turner, as members of the Budget Committee, will work with Doug Mills to reforecast the 2002 budget. Planning for the 2003 Budget will also commence with a projected completion date by July 1, 2002.

10. ANY OTHER BUSINESS.

Ms. Grieser provided an update on the tactical asset allocation strategies.

11. NEXT MEETING

The next meeting of the Board will be held on Wednesday, January 16, 2002 at 1.00 p.m.

12. EXECUTIVE SESSION

An Executive Session followed the Board Meeting.

13. ADJOURNMENT

There being no further business, the meeting was adjourned.